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Supreme Court, U.S.
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No. 00-203

IN THE
Supreme Court of the United States

UNITED STATES OF AMERICA,

Petitioner,

v.

CLEVELAND INDIANS BASEBALL COMPANY, A LIMITED PARTNERSHIP,

Respondent.

On Writ of Certiorari To The United States Court of Appeals for the Sixth Circuit

BRIEF FOR RESPONDENT

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QUESTION PRESENTED

Whether the rule that back pay "wages" are deemed "paid" in "the periods when the regular wages were not paid as usual," *Social Security Board* v. *Nierotko*, 327 U.S. 358, 370 (1946), should apply to both the tax and benefits titles of the Social Security Act, when there is no difference in statutory language and the structure, history, and policy of the Act require symmetry between taxation and benefits?

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BRIEF FOR RESPONDENT

STATEMENT OF THE CASE[1]

Respondent the Cleveland Indians Baseball Company ("Cleveland Indians") is one of 26 Major League Baseball clubs that operated in the years 1985 to 1990. In that period, the relationship between the clubs and the Major League Baseball Players Association ("MLBPA") was governed by a Collective Bargaining Agreement ("CBA"). Beginning in 1986, the MLBPA filed three separate grievances claiming that the clubs violated Article XVIII(H) of the CBA by acting in concert before the 1986, 1987 and 1988 seasons to hinder the movement and depress the salaries of players who, because of their years of service in baseball, were "free agents" (*i.e.*, free to sign a contract to play with any club). The MLBPA further alleged that the concerted action injured players of all seniority levels by depriving them of salary and nonsalary benefits in the period from 1986 to 1990. J.A. 21-22.

Under the CBA, grievances are submitted to an arbitration panel. In 1989 and 1990, an arbitration panel ruled that the clubs had interfered with the contractual rights of the players before the 1986, 1987 and 1988 seasons and that collectively the players suffered damages measured by salary. That ruling did not determine what any individual player's salary would have been absent the injury. Before the panel rendered any decision as to claims of salary damages for years other than 1986, 1987 and 1988, or claims of nonsalary damages in any year, the clubs and the MLBPA settled the three grievances on December 21, 1990. The settlement agreement required the clubs to pay $280 million into two custodial accounts to be administered by a custodian pursuant to a framework for

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[1] This case was decided on stipulated facts. *See* J.A. 21-29.

distributions that would be proposed by the MLBPA and approved by an arbitrator. In 1992, the MLBPA proposed to the arbitrator a partial distribution plan that called for payments to individual players whose claims for salary damages related to the 1986 and 1987 seasons. In February 1994, the arbitrator issued the award for 1986 and 1987 salary damages (plus interest) that is at issue in this case, allocating sums to individual players.[2] J.A. 22-25.

Under the settlement agreement, the Cleveland Indians were considered to be the employer of eight former Indians players who received distributions in 1994 for 1986 salary damages, and 15 former Indians players who received distributions in 1994 for 1987 salary damages. In all, there were 18 different players who received awards, with five players receiving distributions for both 1986 and 1987. With one exception,[3] each of the players had played for (and received wages from) the Cleveland Indians in the year for which he received an award. None of those players played for, or was employed by, the Cleveland Indians in 1994. The 1986 salary damages awarded to former Indians players totaled $610,000 plus $219,638 in interest. The 1987 salary damages totaled $1,457,848 plus $409,119 in interest. J.A. 25-26.

This case concerns the federal employment taxes owed on the awards. The Federal Insurance Contributions Act ("FICA") and the Federal Unemployment Tax Act ("FUTA")

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[2] Subsequently, the arbitrator issued an award in 1995 for 1986 and 1987 nonsalary damages; an award in 1997 for 1988 salary damages; an award in 1999 for 1989 salary damages; and another award in 1999 for 1988 and 1989 nonsalary damages. Awards for later years are still to come.

[3] One player who received a 1987 damages award did not play for respondent in that year, but was deemed to be an employee under the settlement agreement because respondent was the last club that employed him prior to the 1987 season. J.A. 25.

are the names of the two tax titles of the Social Security Act. See Social Security Act Amendments of 1939, ch. 666, sec. 607, § 1432, sec. 615, § 1611, 53 Stat. 1360, 1387, 1396. FICA imposes a tax upon both the employer and the employee based on wages paid or received during a calendar year, for the purpose of funding Social Security and Medicare hospitalization benefits. 26 U.S.C. §§ 3101, 3111. FUTA imposes a tax on qualifying employers based on wages paid during a calendar year to fund unemployment benefits. 26 U.S.C. § 3301.

In 1986 and 1987, for both employees and employers, the FICA Social Security and Medicare tax rates were 5.7 % and 1.45% respectively. See 26 U.S.C. §§ 3101(a), (b); 3111(a), (b) (1982 & Supp. III 1985). Those rates applied only to wages that were within the "contribution and benefit base" established by the Social Security Administration ("SSA") for that year. See *id.* § 3121(a)(1). The base was $42,000 in 1986 and $43,800 in 1987. 50 Fed. Reg. 45,558, 45,559 (1985); 51 Fed. Reg. 40,256, 40,257 (1986). In both 1986 and 1987, the FUTA tax was 6.0% on wages up to $7,000. 26 U.S.C. §§ 3301, 3306(b)(1) (1982 & Supp. III 1985). In 1986 and 1987, all of the players (except one) who later received a back pay award for those years were paid actual wages by respondent in excess of both the FICA and FUTA wage ceilings. Those players thus paid the maximum FICA tax in 1986 and 1987. Respondent also paid the maximum employer FICA and FUTA taxes in 1986 and 1987 on the wages to those players. See App. to Pls.' Mot. Summ. J., Ex. 10, Docket No. 27, No. 96-CV-2240 (N.D. Ohio Jan. 30, 1998) ("Pls. App.") (1986 and 1987 W-2 information).

One of the critical employment tax issues was whether the 1986 and 1987 tax rates and wage ceilings, or their 1994 counterparts, applied to the award for 1986 and 1987 lost salary. In *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946), this Court, construing a provision of the Social Security Act that awarded benefit credits based on "wages"

"paid" in a calendar period, held that back pay "wages" are deemed "paid" in "the periods when the regular wages were not paid as usual." *Id.* at 370. In *Bowman* v. *United States*, the United States Court of Appeals for the Sixth Circuit – in which circuit respondent resides – held that the *Nierotko* relation-back rule governs the taxation of back pay. 824 F.2d 528, 530 (6th Cir. 1987). The Internal Revenue Service ("IRS"), however, has rejected *Bowman* and refused to apply *Nierotko* in assessing taxes, ruling that back pay should be taxed at the rates in effect in the year of the award. Rev. Rul. 89-35, 1989-1 C.B. 280.

The tax consequences of the IRS ruling are considerable. Because the players and respondent had paid the maximum FICA and FUTA taxes in 1986 and 1987, under *Nierotko* and *Bowman* no tax would be owed on the distributions compensating the players for the loss of additional salary in those years.[4] But if the 1994 rates and ceilings applied, both the players and respondent would face significant tax liability, because respondent had paid none of the players any wages in 1994. Such taxes would also be assessed at higher rates and on a much larger wage base.[5]

Because of these and other tax issues, the clubs asked the IRS for a private-letter ruling in 1993. The arbitrator issued the 1994 award, however, before the IRS responded. Given the uncertain tax situation, respondent and the other clubs paid the employer's share of FICA and FUTA taxes on the

[4] The exception would be the one player who was deemed an employee of respondent for the purposes of the 1987 award. Respondent paid him no wages in 1987, so it would owe tax on his distribution.

[5] The employee and employer FICA tax rate had risen in 1994 to 6.2% and the wage base had risen to $60,600. 26 U.S.C. §§ 3101, 3111; 58 Fed. Reg. 58,004, 58,005. The Medicare tax rate had stayed at 1.45%, but the wage ceiling no longer applied to this tax. 26 U.S.C. § 3121(a). The FUTA tax rate had risen to 6.2% on the same wage base of $7,000. 26 U.S.C. §§ 3301, 3306(b).

entire awards as if they were wages paid in 1994. Respondent's FICA tax payment was $99,381.90, and the FUTA payment was $1,008. Respondent also withheld $99,381.90 on behalf of the Cleveland Indians players to pay the employee FICA tax at 1994 rates. J.A. 26.

The IRS issued its private letter ruling on October 18, 1995. It ruled that (1) the individual clubs were properly identified as employers; (2) the interest component of the award was not wages; (3) the damages component was wages; and (4) such wages were to be attributed to 1994. On February 21, 1996, the respondent filed claims with the IRS for refunds of the FICA and FUTA taxes, arguing that neither the interest nor the damages were wages, and, in the alternative, that the back pay should be attributed to the calendar years 1986 and 1987 for tax purposes. Sixteen of the 18 players joined the refund claims, pursuant to 26 U.S.C. § 6413(a). J.A. 26.

Because the IRS had not acted on the refund claim within six months of filing, respondent commenced this action, asserting the same legal arguments set forth in its refund claim. Cf. 26 U.S.C. §§ 6532, 7422.[6] Certain issues were resolved by stipulation. The Government stipulated that the interest was not taxable, and respondent stipulated for purposes of this case that the damages component was taxable "wages."[7] After the stipulation the only remaining issue for summary judgment was whether the *Nierotko* rule applied, such that the back pay wages would be deemed "paid" in

[6] Respondent brought suit to recover only the taxes it had paid, not those of the players who had joined respondent's refund claim pursuant to 26 U.S.C. § 6413(a) and 26 C.F.R. §§ 31.6402(a)-2(a)(2), 31.6413(b)-1.

[7] The difference in tax liability for respondent between a ruling that the damages were not wages and a ruling that the wages related back to 1986 to 1987 was minor (approximately $3,000). *Cf.* J.A. 26 (¶ 14), 27 (¶ 18). Other clubs continue to litigate whether the damages awards are "wages" within the meaning of FICA and FUTA, and this case should not prejudice that litigation.

1986 and 1987. J.A. 26-27. The district court awarded judgment to respondent on the authority of *Bowman*, and the court of appeals affirmed on the same basis. Pet. App. 5a, 10a.

SUMMARY OF ARGUMENT

In its brief, the Government presents this case as a simple one in which its position is assertedly compelled by the plain language of the statute, the legislative history, and Treasury regulations. The simplicity of its argument masks a fundamental error, for it is the Government's position that is contrary to this Court's precedent and the plain meaning of the statute as a whole.

First, the Government's position is irreconcilable with *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946). The Government's argument is that, ever since the Social Security Act Amendments of 1939 ("1939 Act"), federal employment taxes have been assessed based on "wages paid" during a calendar year. According to the Government, the statutory "wages paid" rule necessarily means that a back pay award for lost wages in prior years is taxed in the year of the award. But in *Nierotko*, this Court interpreted parallel "wages paid" language from another part of the 1939 Act that governed eligibility for Social Security benefits. The *Nierotko* Court held that back pay "wages" are deemed "paid" in "the periods when the regular wages were not paid as usual." *Id.* at 370. *Nierotko* thus directly refutes the Government's claim that its position is compelled by the plain text of a "wages paid" statute. Moreover, it is a fundamental principle of statutory construction that the same language in different parts of the same legislation should be interpreted the same way unless there are compelling reasons to do otherwise. *Sorenson* v. *Secretary of Treasury*, 475 U.S. 851, 860 (1986). No such reasons exist, and indeed in *Nierotko* the Government specifically argued to this Court that the tax and benefit titles of the 1939 Act were to be construed *in pari materia*. The

Government does not ask this Court to overrule *Nierotko*, which is still followed by the Social Security Administration. *Nierotko* controls this case.

The Government falls into error because it misapprehends the statutory basis of this Court's relation-back holding in *Nierotko*. It is under the misimpression that the relation-back holding was based on the definition of "wages" in section 210 of the Social Security Act of 1935. Section 210 of the 1935 Act was the basis only for the first question decided in *Nierotko*: namely, whether the back pay award at issue in that case qualified as "wages" within the meaning of the Social Security Act. 327 U.S. at 360, 362-63. But this Court was explicit that the second question decided in *Nierotko* – whether back pay "wages" would be deemed "paid" in the year of the award or the year in which they should have been paid – was based on section 209(g) of the 1939 Act, which made benefits eligibility depend on the "calendar quarters" or "calendar year" in which "wages" had been "paid." *Id.* at 362 n.7, 370 & n.25.

This basic error infects the Government's argument at every turn. It vitiates the Government's principal argument for distinguishing *Nierotko*: namely, that Congress amended the definition of "wages" in section 210(a) of the 1935 Act in the Social Security Act Amendments of 1946 ("1946 Act"). The 1946 Act did not alter section 209(g) of the 1939 Act, the statute on which *Nierotko*'s relation back holding was based. Indeed, far from supporting the Government's position, the 1946 Act refutes it. The 1946 Act adopted a "wages paid" rule for calculating the wage base for purposes of both Social Security benefits and federal employment taxes. It did so only a few months after *Nierotko* had interpreted the meaning of a "wages paid" rule as applied to back pay. The 1946 Act thus must be deemed to have incorporated *Nierotko*'s construction of that statutory language for both the benefits and tax titles of the Social Security Act. *Cannon* v.

University of Chicago, 441 U.S. 677, 696-99 (1979). The 1946 Act further confirms that *Nierotko* controls this case.

The Government's failure to realize that *Nierotko* is a construction of a statutory "wages paid" rule leads it into another critical error. The Government repeatedly argues that adherence to *Nierotko* would resurrect the "wages payable" taxation rules that Congress abandoned in the 1939 and 1946 Acts in order to simplify employer accounting of year-end pay. According to the Government, like the former "wages payable" rule, *Nierotko* would require taxes to be assessed based on the year in which services were performed. The *Nierotko* rule does nothing of the kind. As a construction of "wages paid" language that is necessary for the effective operation of the statute as applied to back pay, *Nierotko* requires taxes to be assessed based on the rates in effect in "the periods when the regular wages were not *paid* as usual," 327 U.S. at 370 (emphasis added), regardless of the year in which services were performed. The Government's entire argument that the *Nierotko* rule conflicts with the statutory text, legislative history, and implementing regulations is built on the misconception that *Nierotko* would restore the "wages payable" rule. Once that error is exposed, the Government's argument topples like a house of cards.

Second, the Government's proposed interpretation of the "wages paid" language in the tax statutes is at odds not only with *Nierotko*, but also with the plain meaning of the statute as a whole. This Court has instructed that "[t]he plain meaning that we seek to discern is the plain meaning of the whole statute, not of isolated sentences." *Beecham* v. *United States*, 511 U.S. 368, 372 (1994); see also *Massachusetts* v. *Morash*, 490 U.S. 107, 115 (1989) ("'in expounding a statute, we [are] not . . . guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy'") (alteration and omission in original) (quoting *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S. 41, 51 (1987)); *United Sav. Ass'n* v. *Timbers Of Inwood Forest*

Assocs., Ltd., 484 U.S. 365, 371 (1988). Both at present and historically the definitions of taxable "wages" and "employment," and of "employers" liable for tax, have depended on some event or status at the time of payment (*e.g.*, some payments are not taxable if paid a certain number of months after employment has ceased). If back pay wages are not deemed "paid" at the time they should have been paid, those definitions are rendered nonsensical. In a number of circumstances, wages that would not have been taxed when they should have been paid become taxable under the Government's rule, penalizing the *employee* for the employer's wrongdoing. In other circumstances, wages that would have been taxed are not taxed, rewarding the employer for its wrongdoing with a windfall and depriving the Social Security trust funds of revenue. The Social Security Act is predicated on wages paid for employment in the ordinary course, and the *Nierotko* rule is necessary for its rational operation in the unusual circumstance of a back pay award.

Finally, as the plain language of the statute and this Court's precedents make clear, the FICA and FUTA taxes on employers are excise taxes on the act of employment. *Charles C. Steward Mach. Co.* v. *Davis*, 301 U.S. 548, 578 (1937). Wages paid in a calendar year are the measure of the tax, but the payment of wages is *not* the act on which the tax is imposed. The Government's rule generates perverse results where identical employment relations are taxed at wildly disparate rates based on arbitrary factors; where, because the SSA continues to apply *Nierotko*, the employee may receive multiple years of benefits credit for a back pay award when only one year of tax is paid, or none at all; and where employers have incentives to create or prolong wage disputes because the Government's rule promises potential reduction or even elimination of taxation. The Government's rule is antithetical to the text, structure, history and policy of the Act, and is inconsistent with this Court's precedents.

No deference is owed to the Government on the question presented. The Treasury Regulations do not even address back pay, and are substantively unchanged from a period in which the IRS held a position on back pay that was rejected as "unsound" by this Court in *Nierotko*. 327 U.S. at 367. Moreover, the Government's argument that application of *Nierotko* would conflict with the regulations again depends on the false presupposition that *Nierotko* requires taxation based on the year in which services were performed. *Nierotko* is a construction of the "wages paid" rule as applied to *back pay* that is fully compatible with the regulation. *Id.* at 370. The IRS has issued revenue rulings that reject *Nierotko*, but those rulings are not entitled to *Chevron* deference, which is reserved to notice-and-comment regulations and adjudications that have the force and effect of law. *Christensen* v. *Harris County*, 120 S. Ct. 1655, 1662 (2000). Regardless, deference is never owed to administrative rulings that are inconsistent with the precedents of this Court and are irreconcilable with the statute, and do not even address (much less justify) the anomalies they create. There is no reasoned basis for the IRS's failure to follow *Nierotko*, and this Court should affirm the judgment below.

ARGUMENT

Ever since the Social Security Act Amendments of 1939, ch. 666, 53 Stat. 1360 ("1939 Act"), federal employment taxes have been assessed based on "wages . . . paid" during a calendar year. 26 U.S.C. §§ 3111 (FICA), 3301 (FUTA).[8] In

[8] The FICA tax on an employee's income is "equal to" specified percentages for a given calendar year "of the wages (as defined in section 3121(a)) *received* by him with respect to employment (as defined in section 3121(b))." 26 U.S.C. § 3101 (emphasis added). "In general, wages are received by an employee at the time that they are paid by the employer to the employee," either actually or constructively. 26 C.F.R. § 31.3121(a)-2(a). Because wages are received when paid, this brief will, for simplicity's sake, refer to all federal employment taxes (including those on the employee) as assessed on a "wages paid" basis.

Social Security Board v. *Nierotko*, 327 U.S. 358 (1946), this Court, construing parallel language from the benefits title of the 1939 Act, held that back pay "wages" are deemed "paid" in "the periods when the regular wages were not paid as usual." *Id.* at 370 & n.25. In the decision below, and in *Bowman* v. *United States*, 824 F.2d 528, 530 (6th Cir. 1987), the court of appeals held that the *Nierotko* rule governs the taxation of back pay. The Government challenges the applicability of *Nierotko* to the tax provisions of the 1939 Act, but its arguments are built on misconceptions. The Government misconceives the statutory basis of *Nierotko*'s relation-back holding, the interrelationship of the tax and benefits titles, and the meaning of the statute as a whole.

The argument of this brief proceeds as follows. Part I.A describes the original Social Security Act of 1935, ch. 531, 49 Stat. 620 ("1935 Act"), and the changes made in the 1939 Act. Understanding the fundamental structure of the Social Security Act is critical to understanding why *Nierotko* is correct that back pay "wages" are deemed "paid" when they should have been paid. Part I.B demonstrates that *Nierotko*'s relation-back holding is based on a "wages" "paid" provision of the 1939 Act, which provision has not been amended in any material respect. That holding was not based on any part of the 1935 Act, as the Government mistakenly contends. Part I.C demonstrates that the Government's argument that *Nierotko* was undermined by the Social Security Act Amendments of 1946, ch. 951, sec. 412, §§ 1426, 1607, sec. 414, § 209, 60 Stat. 978, 989, 990-91 ("1946 Act"), is simply a product of its misconception of the statutory basis of this Court's decision. Indeed, the 1946 Act is fatal to the Government's argument because its adoption of a "wages paid" rule for both the benefits and tax titles in the wake of *Nierotko* must be deemed to have confirmed the *Nierotko* relation-back principle as a generally applicable rule for back

pay. Part I.D shows that the benefits and tax titles of the 1939 Act (as amended) must be construed *in pari materia* as a matter of statutory structure and legislative history. Indeed, the Government specifically argued in *Nierotko* that those titles must be so construed. Part I.E demonstrates that the Government's entire argument – that applying *Nierotko* to the tax titles is in conflict with the statutory text, the legislative history, and Treasury regulations – is based on the false premise that *Nierotko* resurrects the "wages payable" rule abandoned in the 1939 Act. Part II demonstrates the inconsistency of the Government's rule with the plain meaning of other provisions of the statute, and thus with the statute as a whole, and with its object and policy. Finally, Part III explains why the Government's position is not entitled to deference.

I. THE GOVERNMENT'S LEGAL ARGUMENT CONFLICTS WITH THE PLAIN MEANING AND PURPOSES OF THE STATUTES.

A. The Social Security Acts Of 1935 And 1939.

The reliance of Americans on cash wages increased dramatically during the rapid change from a farm-based to an urban industrial economy in this country in the late nineteenth and early twentieth centuries. Martha A. McSteen, *Fifty Years of Social Security* 2 (1985), *available at* http:www.ssa.gov/history/50mm2.html; *Helvering* v. *Davis*, 301 U.S. 619, 642 (1937). With that shift came vulnerability to changing economic conditions. The Great Depression visited destitution upon wage earners, especially the growing number of elderly, who commonly were laid off in favor of stronger younger workers and had no adequate means to support themselves in a wage-based economy. *Helvering* v. *Davis*, 301 U.S. at 642-43; S. Rep. No. 74-628, at 4 (1935).

1. Social Security Act of 1935

Given the insufficient financing of state and local programs to provide income security for the aged, *Helvering* v. *Davis*,

301 U.S. at 644; S. Rep. No. 74-628, at 6, Congress responded by passing the Social Security Act of 1935 to establish old-age benefits funded by employment taxes on wages. 1935 Act, 49 Stat. 620; *Nierotko*, 327 U.S. at 362 ("The benefits are financed by payments from employees and employers which are calculated on wages."). Title II of the 1935 Act established an Old-Age Reserve Account in the Treasury of the United States from which benefits would be paid to "'qualified individual[s],'" defined as those over 65 who had earned at least $2,000 in wages in five years in which they worked after December 31, 1936. 1935 Act, §§ 201(a), 210(c), 49 Stat. at 622, 625. Those benefits were based on a specified percentage of total wages paid to such qualified individuals after that date. *Id.* § 202, 210(c), 49 Stat. at 623, 625. To fund those benefits, Title VIII of the 1935 Act imposed employment taxes on both employees and employers (with certain exemptions) as a percentage of wages "paid" or "received" "with respect to employment during the calendar year[]." *Id.* §§ 801, 804, 49 Stat. at 636, 637. Title IX also imposed an unemployment tax on employers of eight or more employees on the same basis. *Id.* § 901, 49 Stat. at 639. The Bureau of Internal Revenue interpreted those provisions to require that taxes be assessed on wages payable for services performed during a given year, even if not actually paid during that year. Treas. Reg. § 91, arts. 202, 302 (1936).

2. Social Security Act Amendments of 1939

The 1935 Act was recognized even at its passage as "a cornerstone in a structure which is being built but is by no means complete." Statement Of President Roosevelt Upon Signing the Social Security Act, Aug. 14, 1935, *in* 4 *The Public Papers And Addresses Of Franklin D. Roosevelt* 324 (1938). Accordingly, Congress in the 1939 Act substantially revised both the benefits and tax provisions, and thus defined the basic program structure existing today. McSteen, *supra*, at 5 ("Following implementation of the 1939 amendments, the basic Social Security program was in place.").

First, the 1939 Act created the Social Security Trust Fund to pay out benefits. 1939 Act, § 201, 53 Stat. at 1362. Maintaining the link between Social Security taxes and benefits, Congress in the 1939 Act directed that "[t]here is hereby appropriated to the Trust Fund for the fiscal year ending June 30, 1941, and for each fiscal year . . . amounts equivalent to 100 per centum of the taxes . . . received under the Federal Insurance Contributions Act and covered into the Treasury." *Id.* Thus, while Social Security tax "contributions," unlike private pension contributions, do not create in the contributor a property right to benefits against the government, and wages rather than contributions are the statutory basis for calculating an individual's benefits, *Flemming* v. *Nestor*, 363 U.S. 603, 609 (1960), it has always been true that "Social Security taxes are used to pay for Social Security benefits." Social Sec. Admin., SSA Pub. No. 05-10095, *How It's Financed* (Aug. 1999); Robert M. Ball et al., 1994-96 Advisory Council on Soc. Sec., *Social Security for the 21st Century* 35 (1997) ("Social Security is an earned right growing out of past work and contributions, self-financed entirely by dedicated deductions from workers' earnings matched by the employer, by taxes on Social Security benefits, and by earnings on the trust funds."), *available at* http://www.ssa.gov/history/reports/adcouncil/report/ball1.htm.[9]

Second, Congress in 1939 established a common basis for determining both eligibility for Social Security benefits and liability for Social Security taxes: the "wages" that are "paid" during a particular period of the calendar year. On the benefits side, Title II of the 1939 Act created a new section 209 to make eligibility for benefits depend on "wages" that are "paid" during calendar quarters. The Act established two

[9] Social security taxes are used to purchase special Treasury securities that are held by the trusts and redeemed when necessary to secure funds to pay benefits. Social Sec. Admin., SSA Pub. No. 05-10095, *How It's Financed* (Aug. 1999).

categories of beneficiaries: "'fully insured'" and "'currently insured'" individuals, defined in terms of the number of calendar-year quarters of coverage that an individual had accumulated. 1939 Act, § 209(g), (h), 53 Stat. at 1376-77; McSteen, *supra*, at 5 (quarters-of-coverage rule is "[a] method of measuring whether an individual had worked long enough in covered employment to get a benefit"). A "'fully insured' individual" was someone eligible for both old-age and survivorship benefits, whereas a "'currently insured' individual" was eligible only for survivorship benefits. More quarters of coverage were required to reach "fully insured" status. S. Rep. No. 76-734, at 13, 60-61 (1939). The 1939 Act defined a quarter of coverage as (i) "a calendar quarter in which the individual has been *paid* not less than $50 in *wages*" or (ii) any quarter (except the first) "[i]n any case where an individual has been *paid in a calendar year* $3,000 or more in *wages*." 1939 Act, § 209(g), 53 Stat. at 1377 (emphasis added).[10] This is the same benefits scheme that, with minor changes not relevant here, is still in place in the current Social Security Act. 42 U.S.C. § 413(a)(2) (defining quarters of coverage in terms of wages "paid"); *id.* § 414 (defining "'fully'" and "'currently insured'" individuals in terms of quarters of coverage); McSteen, *supra*, at 5 (quarters of coverage is "the measure on which today's methods are based"). The amount of benefits a Social Security beneficiary will receive has also since 1939 related to wages "paid" through the calculation of an average monthly wage. See 1939 Act, §§ 202, 209(e), (f), 53 Stat. at 1363-66, 1376; 42 U.S.C. § 415.

In a parallel change to the tax title of the Act, Title VI of the 1939 Act amended the Internal Revenue Code to calculate Social Security taxes on the basis of "wages" that were "paid"

[10] Although it is technically accurate, given the ordering of the words in the text, to speak of section 209(g) as placing benefits eligibility on a "wages" "paid" basis, for simplicity this brief will use the convention "wages paid" in referring to the section 209(g) rule henceforth.

or "received" during a calendar year. See 1939 Act, sec. 601, § 1400, sec. 604, § 1410, sec. 608, § 1600, 53 Stat. at 1381-82, 1387. As before, the wages subject to tax were limited by a statutory ceiling (in 1939, $3,000). See *id.* sec. 606, § 1426, sec. 614, § 1607, sec. 608, § 1600, 53 Stat. at 1383, 1387, 1392-93. This same structure persists to the present day, and these are the provisions at issue in this case. See 26 U.S.C. §§ 3101, 3111, 3301; *id.* § 3121. The critical point is that the 1939 Act established a "wages paid" rule for both benefits eligibility and taxation.

B. Applying The "Wages Paid" Language Of The 1939 Act, *Nierotko* Held That Back Pay "Wages" Are Deemed "Paid" In The Year In Which They Would Have Been Paid But For The Wrongful Conduct.

In *Nierotko*, this Court decided the proper treatment of back pay under the Social Security Act. Back pay was not expressly addressed in either the statutory text or the legislative history. 327 U.S. at 364. In *Nierotko*, the Ford Motor Company had wrongfully discharged an employee, Nierotko, for union activity. The National Labor Relations Board reinstated Nierotko and ordered back pay for the period of February 2, 1937 to September 25, 1939. Ford paid the back pay award on July 18, 1941. The Social Security Board, however, refused to give Nierotko credit for the back pay in determining his eligibility for benefits and the amount of those benefits. Nierotko filed suit, but the district court affirmed the Board. *Id.* at 359-60. On appeal, the United States Court of Appeals for the Sixth Circuit reversed, holding that back pay was "wages" within the meaning of the Act and had to be apportioned back to the period in which wages would have been paid but for the employer's wrongful conduct. 149 F.2d 273, 274 (6th Cir. 1945). This Court granted certiorari to determine whether the back pay award was "wages" within the meaning of the Act, and, if so, "the proper allocation of such sums to the quarters of coverage for which the 'back pay' was allowed." 327 U.S. at 359.

In tackling the issue of whether the back pay award constituted Social Security "wages," this Court held that the definition of "wages" in the 1935 Act governed that question because it was in effect "[d]uring the period for which 'back pay' was awarded" (*i.e.*, 1937-1939). *Id.* at 360.[11] Section 210(a) of the 1935 Act defined "wages" as "all remuneration for employment," and section 210(b) in turn defined "employment" as "any service, of whatever nature, performed within the United States by an employee for his employer." § 210(a), (b), 49 Stat. at 625.

The Court first held that Nierotko's back pay was "remuneration" within the meaning of section 210(a) of the 1935 Act because it was a reparation for lost wages. *Nierotko*, 327 U.S. at 364-65. The Court next held that back pay was remuneration for "employment" under section 210(b) because it was for an employee's "service," even though the employee did not do any work for the employer between 1937 and 1939. This Court construed the term "service" to encompass the entire employer-employee relationship. *Id.* at 365-66. In reaching this conclusion, the Court rejected the Solicitor General's argument that it should defer to the Bureau of Internal Revenue's contrary administrative interpretation of the term "wages," which had been adopted by the Social Security Board, see *id.* at 367. Cf. Brief for the Social Security Board at 15-18, *Social Sec. Bd.* v. *Nierotko*, 327 U.S. 358 (1945) (No. 318) ("U.S. *Nierotko* Br."). The Court acknowledged that "[the benefits and] tax titles of the Social Security Act have identical definitions of wages and employment," 327 U.S. at 363, but declared the Bureau of Internal Revenue's position "unsound" and "beyond the permissible limits of administrative interpretation." *Id.* at 367, 370.

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[11] The amendments of the 1939 Act did not become effective until January 1, 1940. *Nierotko*, 327 U.S. at 360.

Having established that the back pay awarded to Nierotko met the textual definition of "wages" under section 210 of the 1935 Act, this Court next addressed the Government's argument that back pay could not be apportioned to prior periods for benefits purposes because the "Amendments of 1939 use 'quarters' as the basis for eligibility as well as the measure of benefits and require 'wages' to be 'paid' in certain 'quarters.'" *Id.* at 370 & n.25. Even though the 1935 Act governed the first question of whether the back pay for the period of 1937 to 1939 was "wages," section 209 of *the 1939 Act* was applicable to this second question because it concerned Nierotko's current and prospective eligibility for benefits as a "fully insured" or "currently insured" individual.

Employing the same arguments it renews today, the Government contended that the "wages paid" language of section 209(g) and (h) of the 1939 Act was dispositive. It invoked the provision of section 209(g) that an individual is fully insured only if he has accumulated enough "quarters of coverage" "'in which the individual has been paid not less than $50 in wages.'" U.S. *Nierotko* Br. 10 (emphasis omitted) (quoting § 209(g)(2)). The Government argued that the relation-back holding of the court of appeals was in "conflict[] with the language of the Act," *id.* at 11, because (with the exception of the rule for an individual with $3,000 in annual wages) "quarters of coverage clearly were understood to arise only from those quarters in which 'wage' payments of $50 or more *actually occurred*." *Id.* at 13 (emphasis added).

Significantly, the Government supported this argument by contending that the benefits-eligibility amendment in Title II of the 1939 Act had to be interpreted *in pari materia* with the tax amendments of Title VI of the same Act that assessed taxes based on "wages paid" in the calendar period (*i.e.*, the tax provisions at issue in this case). The Solicitor General pointed out that the new section 209 and the new tax provisions were part of the "same amendatory Act," and that

references to a period "'in which'" "'wages'" were "'paid'" "were used advisedly." *Id.* He argued that "[w]here Congress wished wage payments to be allocated to periods other than the period in which they were actually paid, it knew how to use appropriate language." *Id.* at 13-14. The Solicitor General acknowledged that allocation of the back pay over the period for which it was awarded was necessary to put the employee "in exactly the same position as if he had never been wrongfully discharged," *id.* at 5, but contended that "apportionment of 'back pay' over the entire 'back pay' period would conflict with the express terms of the Act." *Id.* at 14.

This Court unanimously rejected the Government's putative plain-language argument. The requirement of the 1939 Amendments that "'wages' . . . be 'paid' in certain 'quarters'" did not dictate such a perverse result, 327 U.S. at 370. In interpreting the statutory text as applied to back pay, which by its nature is a reparation to make the wronged employee whole, *id.* at 364, this Court adopted a relation-back principle that deems wages to be "paid" in the year the wages should have been paid: "If, as we have held above, 'back pay' is to be treated as wages, we have no doubt that it should be allocated to the periods when the regular wages were not paid as usual." *Id.* at 370. Indeed, this Court could not logically have reached any other result. If the characterization of the back pay as statutory "wages" is resolved by reference to "the period for which 'back pay' was awarded" (*i.e.*, 1937-1939), *id.* at 360, then necessarily the question of when such "wages" are deemed "paid" likewise must relate back to that period. Moreover, it would be contrary to the very purposes of the Act if an employee would fail to qualify for *any* benefits under the Act – by having too few quarters of coverage to qualify as a "fully insured" or "currently insured" individual – because of an employer's wrongdoing.

C. The Government's Argument That *Nierotko* Was Undermined By The 1946 Act Is Based On Its Misunderstanding Of This Court's Decision.

The Government's efforts to distinguish *Nierotko* are not only unpersuasive but ultimately puzzling. Its principal argument is that *Nierotko* was based on the definition of "wages" in section 210(a) of the 1935 Act, and that one part of that definition – the $3,000 ceiling on remuneration in a calendar year that counts as "wages" for Social Security purposes – was amended in 1946 along with the corresponding provisions of FICA and FUTA. U.S. Br. 26-27; see 1946 Act, sec. 412, §§ 1426, 1607, sec. 414, § 209, 60 Stat. at 989, 990-91.

This argument is utterly irrelevant and wrong, and based on a flat misreading of *Nierotko*. First, the wage ceiling was not at issue in *Nierotko*. Second, and more critically, as noted above, *Nierotko* relied on section 210(a) of the 1935 Act only to determine whether "back pay" fit the statutory definition of "wages." 327 U.S. at 360, 362-63. That issue is not contested here, and indeed the parties have stipulated in this case that the particular award here qualifies as "wages" within the meaning of the Act (although other Major League Baseball clubs are litigating that question in other cases). Solely at issue here is *Nierotko*'s relation-back holding. *That* holding was based on section 209(g) of the *1939 Act* (the "wages paid" rule for determining benefits eligibility) and not on any provision of the 1935 Act. 327 U.S. at 370. Thus, the Government does not even acknowledge the statutory "wages paid" basis of *Nierotko*'s relation-back holding, even though it was the Government that relied upon section 209(g) of the 1939 Act in its argument to the Court in *Nierotko*. Cf. U.S. *Nierotko* Br. 4 (raising the proper interpretation of section 209(g) in its specification of errors).

Indeed, far from supporting the Government's position, the 1946 Act is fatal to it. The critical point is that the 1946 Act adopted a "wages paid" rule for the calculation of the Social

Security wage base for both benefits *and* taxes. 1946 Act, sec. 412, §§ 1426, 1607 (amending the definition of wages in FICA and FUTA), sec. 414, § 209(a) (amending the definition of wages in the benefits title), 60 Stat. at 989-91. On the benefits side, Congress amended section 209(a) of the benefits title to adopt a "wages paid" rule for the calculation of the Social Security wage base. See *id.* sec. 414, § 209(a), 60 Stat. at 990-91. It did so only a few months after *Nierotko* interpreted the "wages paid" benefits-eligibility rule of section 209(g) of that same title to mean that back pay would be "allocated to the periods when the regular wages were not paid as usual," *Nierotko*, 327 U.S. at 370. By using the same "wages paid" language in the amendment of section 209(a) that was already in place in section 209(g), Congress is presumed to have intended the 1946 Act to be interpreted consistently with *Nierotko*. *Cannon* v. *University of Chicago*, 441 U.S. 677, 696-99 (1979) (when Congress uses identical language from a prior statute in a later enactment, it is presumed to intend that judicial interpretations of the prior statute will apply); *Cottage Sav. Ass'n* v. *Commissioner*, 499 U.S. 554, 562 (1991). Surely the Government cannot contend that, after the 1946 Act, "wages paid" meant different things in subsections (a) and (g) of section 209 of the benefits title (Title II) of the Social Security Act.

Because the 1946 Act's amendment of section 209(a) of the benefits title incorporates *Nierotko*'s "wages paid" interpretation, so too does the 1946 Act's amendment of the tax titles. The House Report specifically states that Congress used the identical "wages paid" language in the 1946 Act to amend the definition of FICA and FUTA "wages" in the tax code to "*conform*[] with the changes in section 209(a) of title II of the Social Security Act," H.R. Rep. 79-2447, at 35 (1946) (emphasis added). This puts to rest whatever remains of the Government's argument that a different rule should apply to the tax and benefit titles. As the Sixth Circuit properly held in *Bowman* and the decision below, *Nierotko*

governs the assessment of taxes on back pay awards. 824 F.2d at 530. "Wages paid" has a single meaning throughout the tax and benefits titles of the Social Security Act. Back pay "wages" are deemed "paid" for purposes of the employer FICA and FUTA taxes, 26 U.S.C. §§ 3111, 3301, in the period when they should have been paid. Given that wages are received when paid, 26 C.F.R. § 31.3121(a)-2(a), such wages are deemed "received" for purposes of the employee FICA tax, 26 U.S.C. § 3101, in the period when they should have been received.

D. The Government's Argument That The Tax And Benefits Titles Are Not To Be Construed *In Pari Materia* Is Contrary To The Act's Structure And History And The Government's Prior Arguments To This Court.

The Government's second argument for distinguishing *Nierotko* is that the Social Security benefit provisions should not be construed *in pari materia* with the Social Security tax provisions. U.S. Br. 28-29 (arguing that the "Social Security Administration is a different agency, implementing a different statutory scheme" (internal quotation marks omitted)). But that is the exact opposite of the position it took in 1945, a year much closer in time to the 1939 Act. Then it argued (correctly) that the "wages paid" language in the Title II benefits amendments of the 1939 Act was used "advisedly" and had exactly the same meaning as the "wages paid" language in the Title VI tax amendments that is at issue now in this case. U.S. *Nierotko* Br. 13. Accordingly, if faithful to its earlier position, the Government would concede that *Nierotko* must control this case. Regardless of the reason for the Solicitor General's unexplained reversal of position, this Court discounts the arguments of the Government when it switches positions. See *Norfolk S. Ry.* v. *Shanklin*, 120 S. Ct. 1467, 1474-76 (2000).

In any event, the Government's prior view of the relationship between the "wages paid" language in the

benefits and tax titles of the 1939 Act is clearly correct. "The normal rule of statutory construction assumes that '"identical words used in different parts of the same act are intended to have the same meaning."'" *Sorenson* v. *Secretary of Treasury*, 475 U.S. 851, 860 (1986) (quoting *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, 87 (1934) (quoting *Atlantic Cleaners & Dyers, Inc.* v. *United States*, 286 U.S. 427, 433 (1932))). This rule was well settled when Congress passed the 1939 Act.

The presumption of identical meaning is strengthened here by the broad and conscious parallelism between the tax and benefits titles of the 1939 Act, which Congress has steadfastly maintained to the present. The substantive definitions of "wages" and "employment" have always been essentially identical for both tax and benefit purposes. *Nierotko*, 327 U.S. at 363; compare 26 U.S.C. § 3121(a), (b) with 42 U.S.C. §§ 409, 410.[12] The same ceiling on wages – which is expressly denominated "the contribution and benefit base" – has always been used for both Social Security taxes and benefits. See 42 U.S.C. § 430; 26 U.S.C. § 3121(a). The benefits and tax titles of the Social Security Act simply cannot be regarded as unrelated schemes, as this Court emphasized in *United States* v. *Silk*, 331 U.S. 704 (1947):

> Employment taxes . . . are necessary to produce the revenue for federal participation in the program of alleviation. . . . As a corollary to the coverage of employees whose wages are the basis for the employment taxes under the tax sections of the social security legislation, rights to benefits payments under federal old age

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[12] Congress has been vigilant to ensure symmetry in the benefits and tax titles. For example, in 1983, it corrected a disjunction whereby employer contributions to simplified employee pensions (SEPs) were wages for benefits purposes but not for tax purposes by amending the statute to require the same treatment of those contributions in both titles. See H.R. Rep. No. 98-25, at 77 (1983), *reprinted in* 1983 U.S.C.C.A.N. 219, 296.

> insurance depend upon the receipt of wages as employees under the same sections. 53 Stat. 1360, §§ 202, 209(a), (b), (g), 205(c)(1). See *Social Security Board* v. *Nierotko*, 327 U.S. 358. The relationship between the tax sections and the benefits sections emphasizes the underlying purpose of the legislation – the protection of its beneficiaries from some of the hardships of existence.

Id. at 710-11.

The legislative history of the 1939 Act confirms that the tax and benefits titles of the Social Security Act must be construed *in pari materia*. The selection of "wages paid" in a calendar period as a common basis for taxation and benefits reflected Congress's decision to preserve the essential character of Social Security as a solvent "contributory" system of social insurance. The 1939 Act was animated by a desire to accelerate and liberalize benefits by extending them to families of workers and the disabled, but "without increasing the future cost of the old-age insurance system." H.R. Rep. No. 76-728, at 2, 7 (1939); S. Rep. No. 76-734, at 2, 6. Even as it liberalized benefits, however, Congress insisted that "the contributory basis of our old-age insurance system be strengthened and not weakened." S. Rep. No. 76-734, at 2, 6. The House and Senate Reports both stated the philosophy of the 1939 Act as follows:

> By relating benefits to contributions or earnings, contributory old-age insurance preserves individual thrift and incentive; by granting benefits as a matter of right it preserves individual dignity. Contributory insurance therefore strengthens democratic principles and avoids paternalistic methods of providing old-age security. Moreover, a contributory basis facilitates the financing of a social-insurance scheme and is a safeguard against excessive liberalization of benefits as well as a protection against reduction of benefits.

Id. at 6.

More specifically, the Senate Report emphasized the importance of having benefits eligibility relate to the periods in which contributions had been made. The 1939 Act's change to a rule where benefits eligibility is based on wages paid during a certain number of calendar periods "permit[s] a smoother progressive increase in the eligibility requirements as the insurance system matures," which is "essential in order to make certain that the benefits bear a reasonable relationship to contributions and wage loss." *Id.* at 14. In the short run period of transition, the 1939 Act would authorize large benefits to persons who had made limited contributions, but in the long run an individual's benefits would be "reasonably related to contributions and loss of earnings." *Id.*; see also H.R. Rep. No. 76-728, at 13 ("The present law permits persons who are in insured employment for only a short time to receive very large benefits in comparison to their contributions. In order to reduce the cost of paying benefits to these persons who shift between insured and uninsured employment, there have been added [eligibility] provisions to protect the system in future years."). Thus, placing benefits eligibility and tax contributions on a common footing was an essential element of the 1939 Act scheme that remains in effect today.[13]

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[13] The tax amendments of the 1939 Act had the added virtue of simplifying employer recordkeeping by placing FICA and FUTA taxes on a cash rather than an accrual basis. Existing law had tied payroll taxes to the "wages payable" for service in a calendar year, which Congress feared would "unnecessarily complicate the making of returns and the collection of the taxes in later years when the rate of tax has been increased." H.R. Rep. No. 76-728, at 57; S. Rep. No. 76-734, at 70. The example given was the common instance of lag pay, in which an employee would receive wages in 1943 for services performed in 1942. *Id.* Moreover, the wages-payable rule was problematic "[i]n cases in which remuneration for services of an employee in a particular year is based on a percentage of profits, or on future royalties, the amount of which cannot be determined until long after the close of the year." H.R. Rep. No. 76-728, at 62; S. Rep. No. 76-734, at 75. To avoid unnecessary complexities, Congress

There is thus no basis for distinguishing *Nierotko* in the tax context. Indeed, the Commissioner of Internal Revenue, in a 1946 advisory to tax collectors on the heels of this Court's decision, stated that "the decision of the Supreme Court is controlling for Federal employment tax purposes in determining the status of back pay awarded pursuant to an order of the National Labor Relations Board," given the parallel statutory language in the benefits and tax titles. Mim. 6040, 1946-2 C.B. 155, 155. Nonetheless, in the same notice, the Commissioner, without explanation, failed to require taxes to be collected in compliance with the relation-back holding of *Nierotko* that this Court declared a necessary corollary of interpreting back pay to be Social Security "wages," 327 U.S. at 370, despite the parallel "wages paid" statutory language in the relevant tax and benefits sections. See *id.* The IRS's current position perpetuates this unreasoned approach.

E. The *Nierotko* Rule Does Not Resurrect The "Wages Payable" Rule Abandoned In The 1939 Act.

The Government also claims that recognition of the *Nierotko* rule would constitute a return to the "wages payable" rule of the 1935 Act, and frustrate the 1939 Amendments by making tax rates depend on the year in which service is performed. See, *e.g.*, U.S. Br. 9, 35. This argument again reflects the Government's misunderstanding of *Nierotko*.

The relation-back principle adopted in *Nierotko* is a constructive rule specific to *back pay* for determining when wages are "paid"; it requires that the back pay be "allocated

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amended the tax titles to base the tax on "the rate in effect at the time that the wages are paid and received without reference to the rate which was in effect at the time the services were performed." H.R. Rep. No. 76-728, at 58; S. Rep. No. 76-734, at 71. This aspect of the legislative history is discussed *infra* at 40.

to the periods when the regular wages *were not paid as usual*." 327 U.S. at 370 (emphasis added). It says nothing about the time when services are performed, or when wages are "payable," for indeed this Court was construing a provision – section 209 (g) of the 1939 Act – that made benefits eligibility depend only on when wages are "paid."

The Government is simply mistaken in arguing that *Nierotko* would require taxes to be assessed based on the year in which services were performed. Take the example from the Treasury regulations where an employee is paid $1,000 in 1973 for services performed in 1972. 26 C.F.R. § 31.3101-2(c). In the ordinary course, under the 1939 Act, taxes are assessed at rates in effect in 1973 (the year of payment) and not 1972 (the year of service). *Id.* The same is true under *Nierotko*. If the employee had been unlawfully denied that $1,000 and then had received that amount in a back pay award in 1980, she would be taxed at the 1973 rates (the year in which she should have been paid), not the 1972 rates (the year of service). Contrary to the Government's claims, U.S. Br. 14-19, 23-24, the *Nierotko* rule is thus fully in keeping with the legislative history of the 1939 and 1946 Acts, which require taxes to be assessed "without reference to the rate which was in effect at the time the services were performed." H.R. Rep. No. 76-728, at 58; S. Rep. No. 76-734, at 71.[14]

By returning to the *status quo ante* and assessing taxes at the rate at which they would have been assessed but for the employer's wrongful act (*i.e.*, the rate at the time of regular payment), the *Nierotko* rule does nothing more than make both the employee and the Government whole without penalizing the employer (because FICA and FUTA taxes are

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[14] Despite the Government's claims that its back pay rule is amply supported in the legislative history, it is notable that all of the examples it draws from those sources deal only with year-end or "lag" pay (*i.e.*, wages paid in the current year for services performed in a prior year). U.S. Br. 14-19, 23-24.

not penal in nature). It is simply a rule that gives the Social Security tax statutes their intended effect. Indeed, back pay for a given year has nothing to do with "wages payable," which refers to remuneration that the employee has earned in a certain year but as to which "no obligation to pay it existed in that year." S. Rep. No. 76-734, at 75. Back pay instead restores that which the employer was obligated to pay an employee in a given year so that the employee is "made whole." *Phelps Dodge Corp.* v. *NLRB*, 313 U.S. 177, 196 (1941).

There is nothing unusual in this Court's adoption of a constructive rule to ensure that a statute operates consistently with its purposes in exceptional circumstances. Although clearly within the ambit of the statute, back pay has always constituted a tiny fraction of the amount of wage payments covered by the Act.[15] The *Nierotko* rule is not different in kind from the constructive payment rules that the IRS has adopted under FICA and FUTA to effectuate the purposes of the statute in other anomalous circumstances.[16] Nor is it different in kind from this Court's repeated recognition of constructive rules to effectuate the purposes of the income tax legislation, where broad rules must be interpreted to fit multifarious circumstances in keeping with the purposes of the Act. For example, in *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84 (1934), this Court deemed the United States Government a "resident" of the United States for tax purposes, and thus held that interest paid to an alien

[15] *Compare Nierotko*, 327 U.S. at 360 n.4 (the NLRB made back pay awards to about 30,000 employees in 1939-45) *with* H.R. Rep. 76-728, at 4 (Social Security wages reported for 32,000,000 employees in 1937-38).

[16] By regulation, wages are deemed "constructively paid" or "received" if it is within the power of the employee to reduce the money to possession, even if he is not actually paid at that time. 26 C.F.R. § 31.3121(a)-2(a), (b). The IRS has also adopted specific regulations as to when "cash remuneration" will be deemed paid within a calendar quarter. *Id.* § 31.3121(a)-2(c).

corporation on a federal tax refund could be taxed as "'interest on . . . interest-bearing obligations of residents.'" *Id.* at 86, 92. The Court declared that "a contrary holding would defeat the evident purpose of [the] statute." *Id.* Deeming the Government a "resident" "may be in the nature of a legal fiction," the Court stated, "but legal fictions have an appropriate place in the administration of the law when they are required by the demands of convenience and justice." *Id.*[17]

Similarly, this Court has recognized that "[a]s the federal social security legislation is an attack on recognized evils in our national economy, a constricted interpretation of the phrasing by the courts would not comport with its purpose," and would "invite adroit schemes by some employers and employees to avoid the immediate burdens at the expense of the benefits sought by the legislation." *Silk*, 331 U.S. at 712 (construing definition of taxable "employment"). *Nierotko* is squarely within this tradition. It is not a departure from the plain language but a construction of it in an exceptional circumstance to ensure that benefits are credited and taxes assessed in keeping with the purposes of the Act.

Nierotko is thus controlling precedent on the meaning of "wages paid" language in the Social Security Amendments of

[17] *Cf. Hillsboro Nat'l Bank* v. *Commissioner*, 460 U.S. 370, 377 (1983) (describing the tax-benefit rule as "a judicially developed principle that allays some of the inflexibilities of the annual accounting system") (footnote omitted); *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334 (1945) (attributing a gain from sale of an asset to a corporation, rather than the actual seller, in order to promote "the effective administration of the tax policies of Congress"); *Douglas* v. *Willcuts*, 296 U.S. 1, 9 (1935) (discharge of taxpayer's debt by another is income "received" because it is "regarded as being the same in substance as if the money had been paid to the taxpayer and he had transmitted it to his creditor"); *Helvering* v. *F. & R. Lazarus & Co.*, 308 U.S. 252, 255 (1939) (rejecting Commissioner's literal interpretation that the statutory right to depreciation follows legal title, and looking to the substance of a transaction to determine tax liability).

1939, as applied to back pay. The Government does not ask this Court to overrule *Nierotko*, and (mistaking the statutory basis for its holding) advances no coherent basis for distinguishing it. The Government never explains the fundamental inconsistency in its position that it accepts the *Nierotko* relation-back principle for determining the taxability of "wages" under the statute, cf. 327 U.S. at 360, but not for determining the rate of tax, cf. *id.* at 370. This Court does not lightly depart from a precedent that underlies a complex regulatory system and concerns a statute that has been the subject of frequent attention from Congress without contrary amendment. *California* v. *FERC*, 495 U.S. 490, 499 (1990). The Government has given this Court no reason to question the continuing validity and applicability of *Nierotko*.[18]

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[18]Although employment and income tax are separate regimes, *cf.* 26 U.S.C. §§ 3121(a), 3306(b) (indicating that the definition of "wages" in income tax provisions is not controlling for FICA and FUTA purposes), the *Nierotko* rule is fully consistent with the treatment of back pay for income tax purposes at the time of the 1939 and 1946 Acts. A few months prior to the 1939 Act, Congress enacted section 107 of the Internal Revenue Code to deal with the situation in which compensation is paid upon completion of work that is performed over an extended period (5 years or more). Congress eliminated any tax penalty for the delay of payment, providing that "the tax attributable to such compensation shall not be greater than the aggregate of the taxes attributable to such compensation had it been received in equal portions in each of the years included in such period." Revenue Act of 1939, ch. 247, § 220a, 53 Stat. 862, 878. In 1943, in an amendment applicable to tax years from 1941 onwards, Congress created a new subsection (d) of section 107 to address the specific circumstance of back pay. It provided that, where back pay exceeded 15% of gross income in a taxable year, the tax imposed upon such back pay "shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable" according to Treasury regulations. Revenue Act of 1943, ch. 63, sec. 119(a), § 107(d), 58 Stat. 21, 39. In justifying its relation-back holding against claims of administrative difficulty, this Court in *Nierotko* specifically noted that back pay was "treated distributively" under the Revenue Act of 1943. 327 U.S. at 370 n.26; sec. 119(a), § 107(d), 58 Stat. at 39. There is no reason to infer that Congress, in the 1939 and 1946 amendments to the Social Security Act, did not intend a similar distributive taxation of back pay under FICA and FUTA to avoid any tax penalty befalling the injured employee.

II. THE GOVERNMENT'S RULE IS INCONSISTENT WITH THE PLAIN LANGUAGE OF THE STATUTE AS A WHOLE AND ITS PURPOSES.

The foregoing section demonstrates that, even if statutory analysis is confined to the "wages . . . paid" and "wages . . . received" clauses in 26 U.S.C. §§ 3101, 3111, and 3301, the Government's proposed rule is unsound. But this Court has admonished that "[w]e do not . . . construe statutory phrases in isolation; we read statutes as a whole." *United States* v. *Morton*, 467 U.S. 822, 828 (1984); *Bailey* v. *United States*, 516 U.S. 137, 145 (1995); *King* v. *St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991). "Statutory construction . . . is a holistic endeavor" directed to determining which among "permissible meanings produces a substantive effect that is compatible with the rest of the law." *United Sav. Ass'n* v. *Timbers Of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). Thus, the meaning of a tax statute, like any other, "'is to be ascertained, not by taking the word or clause in question from its setting and viewing it apart, but by considering it in connection with the context, the general purposes of the statute in which it is found, the occasion and circumstances of its use, and other appropriate tests for the ascertainment of the legislative will.'" *Commissioner* v. *Wodehouse*, 337 U.S. 369, 379 (1949) (quoting *Stockholm Enskilda Bank*, 293 U.S. at 93).

A. The Government's Rule Is Inconsistent With The Rational Operation Of Other Statutory Provisions.

The Government's back pay rule cannot be reconciled with the statute as a whole. The tax provisions of the Social Security Act (FICA and FUTA) are reticulated schemes in

which Congress has carefully defined what types of wages or employment are subject to taxation. Both historically and in the present, the statute has frequently defined the taxability of wages or employment based on some event or status at the time of *payment:* Treating wages as "paid" at the time of the back pay award leads to manifestly absurd results that defeat the statutory purpose. Under the Government's rule, wages that were never meant to be taxed become taxable, and wages that would have been taxed are exempted – thus rewarding the employer for its wrongdoing. Adherence to *Nierotko* would avoid these absurd results. See *Haggar Co.* v. *Helvering*, 308 U.S. 389, 394 (1940) (rejecting Government's mechanical reading of a statute governing amended returns, noting that "[a] literal reading of [statutes] which would lead to absurd results is to be avoided when they can be given a reasonable application consistent with their words and with the legislative purpose"); *Green* v. *Bock Laundry Mach. Co.*, 490 U.S. 504, 527 (1989) (Scalia, J., concurring in the judgment).

1. Definition of Taxable "Wages"

Congress has defined taxable wages as "all remuneration for employment," 26 U.S.C. § 3121(a), but also has declared numerous exemptions for policy reasons. *Id.* § 3121(a)(2)-(21). Because the taxability of wages depends frequently on an event or status at the time of payment, the Government's proposed back pay rule has nonsensical results. Among the many examples that could be listed are the following:

Sickness or Accident Disability Benefits. Congress has excluded from "wages" "any payment on account of sickness or accident disability," including coverage of medical and hospitalization expenses, made by an employer to an employee "after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer." *Id.* § 3121(a)(4). This provision was added to cover payments that are not under a general disability plan, which are addressed by section 3121(a)(2).

See S. Rep. No. 81-1669 (1950), *reprinted in* 1950 U.S.C.C.A.N. 3287, 3424. The six-month period is meant to distinguish wages from true gratuities or disability benefits. A back pay award may encompass the failure to pay sickness and accident payments actually owed to an employee, including short-term sick pay or disability benefits or any medical or hospital expenses during the course of employment. Under the Government's rule, all such payments would be exempt from tax if the employee has not worked for the employer for at least six months prior to the *back pay* award. Congress did not intend for this provision to operate in such a fashion, and the Government's rule supplies nothing more than a windfall for the wrongdoing employer – and indeed an incentive for the employer to engage in wrongdoing – that would be averted by application of the *Nierotko* rule. See *Maximov* v. *United States*, 373 U.S. 49, 56 (1963) (interpreting tax treaty to "prevent[] an unintended tax windfall to a private party"); *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, 389 (1957) (same regarding federal tax statute).

Retired Judges. Retired federal judges and justices continue to receive the salary of their office so long as they perform judicial or administrative service that satisfies minimum statutory requirements. 28 U.S.C. § 371(b), (f). A retired judge or justice may also on occasion accept an assignment to active duty. See *id.* § 294. If a retired judge or justice performs judicial service on assignment to active duty, Congress has exempted from FICA taxation any salary payment "which is received during the period of such service." 26 U.S.C. § 3121(i)(5). In other words, salary payments to retired judges and justices are subject to FICA except during the period of active-duty service. Under the Government's rule that treats back pay as "paid" or "received" at the time of the award, a retired federal judge or justice who receives a back pay award covering active-duty service after service is complete must pay the full amount of FICA tax. This is contrary to the clear congressional intent

that such compensation should be untaxed. Under the *Nierotko* rule, the payment would be deemed to relate back to the period of service, and the absurdity would be avoided.

Payments To Estates Or Survivors. Congress has exempted from FICA tax "any payment made by an employer to the survivor or the estate of a former employee after the calendar year in which such employee died." 26 U.S.C. § 3121(a)(14). The reason for the exemption is that qualification for, and the amount of, Social Security survivor benefits are calculated only on the basis of wages paid through the calendar quarter (or year) of death. Cf. 42 U.S.C. §§ 413(a)(2), 415(b). Given the fundamental policy of the Act that benefits be "reasonably related to [tax] contributions," S. Rep. No. 76-734, at 14, Congress created this exemption because it would be unfair to tax wages that do not count for benefits purposes. S. Rep. No. 92-1230, at 29 (1972).

Under *Nierotko*, back pay wages received after the employee's death are deemed "paid" in "the periods when the regular wages were not paid as usual." 327 U.S. at 370. Thus, the "wages" would be deemed "paid" in the calendar periods prior to death, and would count for benefits purposes. This is one of the most important applications of *Nierotko*. Without the relation-back principle of *Nierotko*, surviving widows and children, whose needs are often acute, could lose benefits altogether (or have benefits substantially reduced) because of the employer's wrongdoing.

The Government's proposed rule destroys the parity between benefits and taxes that Congress sought to maintain with this exemption. Under the Government's misguided rule, no tax is assessed on the back pay wages, even though the crediting of those wages under *Nierotko* obligates the Government to pay higher benefits. Moreover, the Government's rule perversely transforms this exemption into an unjustifiable windfall for the wrongdoing employer, who is relieved from FICA tax liability simply on the happenstance

that the employee dies in the (often long) intervening period before back pay is awarded.

The 1994 arbitrator's award directly implicates this exemption. Two players who received substantial back pay awards for 1986 and 1987 – Donnie Moore and Rod Scurry – died tragically in 1989 and 1992, respectively. Under the Government's rule, the clubs for whom they played in 1986 and 1987 are not liable for any tax on the payment to their estates because the back wages were "paid" in a calendar year after they died (1994). It is irrational to interpret the statute to treat back pay to Moore and Scurry for playing baseball in 1986 and 1987 any differently from that awarded to other players. This situation may arise frequently, for example, when elderly employees sue for back pay under the Age Discrimination In Employment Act.

2. Definition of Taxable "Employment"

Congress also has historically tied the taxability of certain employment relations to the amount of remuneration paid. For example, in the 1939 Act, services performed for a tax-exempt organization in a calendar quarter were exempt from FICA and FUTA tax if the remuneration did not exceed $45 *in that quarter*. 1939 Act, sec. 606, § 1426(b)(10), 53 Stat. at 1384-85. Service by a student employee of any school, college, or university was also exempt if the wage did not exceed $45 (after room, board, and tuition) in the quarter when the service was performed. *Id.* at 1385. In 1950, Congress also exempted agricultural labor and service not in the course of the employer's trade or business unless quarterly wages were at least $50 *and* the employee was regularly employed by the employer in that quarter. Social Security Act Amendments of 1950, ch. 809, sec. 204(a) § 1426(b), 64 Stat. 477, 528-29.[19]

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[19] In 1939, the average annual wage for workers in all industries was only $1,266 (about $316 per quarter). *The Value Of A Dollar, 1860-1999,*

The Government does not apparently contest that, in determining the taxability of employment, a court must look back to the period for which the back pay was awarded and determine whether the services that would have been performed were covered by a statutory exemption. Cf. 26 U.S.C. §§ 3121(b), 3306(c). For provisions where the taxability of employment depends on the amount of remuneration paid in a quarter of service, however, the Government's rule makes no sense. Take, for example, a regularly employed agricultural laborer who was to have been paid $3,600 per year ($900 per quarter). Those wages, which were within the 1950 wage base, would thus have been subject to tax. Cf. 1950 Act, § 203(a), 64 Stat. at 525 (wage ceiling of $3,600). The laborer is unlawfully terminated in 1951. He wins a $7,200 back pay award in 1955 covering the years 1952 and 1953. Under the *Nierotko* rule, the back pay is attributed back to the quarters he would have worked, and the employer properly would owe tax on those wages. Under the Government's rule, however, the wrongdoing employer would avoid the tax because there would be no quarter of service in which the employee is *both* (1) paid wages of $50 or more *and* (2) regularly employed by that employer. See 26 U.S.C. § 3306(c). In other words, under the Government's rule, the *employment relation itself* would become nontaxable simply because of the timing of the back pay award.

Conversely, it would be absurd if employment that is tax-exempt (*e.g.*, agricultural, student, or nonprofit labor where wages were only $40 per quarter) became taxable simply because a back pay award aggregated multiple quarters. The Government's rule thus cannot be a viable interpretation of the 1939 Act. The Social Security Act is predicated on wages paid for employment in the ordinary course, and the *Nierotko* rule is necessary for its rational operation in the unusual circumstance of a back pay award.

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at 207 (Scott Derks ed., 1999). The average annual wage for farm labor was $436 in 1939 and $1,454 in 1950. *Id.* at 207, 278.

3. Definition of a Taxable "Employer"

The Government's rule also makes nonsense of the Act's definition of an "employer" subject to FUTA. FUTA defines an "employer" subject to tax based on (1) the amount of "wages" that are "paid" "during any calendar quarter" of the current or prior "calendar year," or (2) the number of days in a current or prior "calendar year" in which he has employed at least one individual. 26 U.S.C. § 3306(a)(1). The wages-paid prong of the test was not added until 1970, and the legislative history of that amendment makes clear (as does the statutory text) that both prongs refer to the same "taxable year or the preceding taxable year." H.R. Conf. Rep. No. 91-1037 (1970), *reprinted in* 1970 U.S.C.C.A.N. 3646, 3646. It would plainly be absurd, as the Government's rule requires, for an employer's FUTA liability to depend on the number of days in which a person had employed any individual in the year of (or prior to) the *back pay award*.

Moreover, the specific statutory definition of an "agricultural employer" demonstrates the unsoundness of the Government's position. An agricultural employer is a statutory "employer" liable for unemployment tax only if he (1) "during any calendar quarter in the calendar year or the preceding calendar year paid wages of $20,000 or more for agricultural labor" or (2) employed 10 or more individuals on some portion of 20 days in the current or preceding calendar year. 26 U.S.C. § 3306(a)(2). First, assume a farmer paid $100,000 total in qualifying agricultural wages in a calendar quarter in 1990 (and thus is an agricultural employer under FUTA in 1990), but reneged on an additional $10,000 that should have been paid to certain employees and that would have been subject to FUTA tax. He pays a back pay award of $10,000 in 1993, but in that year and the year prior he does not pay enough agricultural wages or hire enough laborers to meet the statutory test of an "agricultural employer." Under the Government's rule, he escapes tax by virtue of his

wrongdoing. Under *Nierotko*, the wages would be deemed paid in 1990, and he would pay the applicable taxes.

Second, assume the same facts except that the 1993 back pay award is in the amount of $50,000. The farmer enters into a settlement with the employees to spread the $50,000 back pay over four quarters in 1993, thus escaping unemployment tax altogether under the Government's rule because again he would not have met the threshold of quarterly wages (at least $20,000) to qualify as an "employer" in the year of the back pay award. Here, too, the wrongdoer avoids taxation that he should have paid but for his illegal conduct. Under *Nierotko*, the $50,000 award would relate back to 1990, and would be taxed as it would have been absent the wrongful acts.

The Government's rule, unlike the *Nierotko* rule, is thus subject to strategic manipulation. This Court should not adopt a rule where certain employers (if they are under the wage cap with regard to particular employees) have incentives to create or prolong wage disputes so that taxation might be reduced in amount or eliminated altogether. See *United States* v. *Silk*, 331 U.S. 704, 712 (1947). Under the *Nierotko* rule, an employer, whether under the wage cap or not, never has a tax incentive to create wage disputes because the tax always relates back to the year when the wages should have been paid.

In sum, the entire statutory structure of the Social Security Act (both in terms of benefits and taxes) is predicated on wages that are paid in the ordinary course as remuneration for employment. The *Nierotko* relation-back rule is not only essential for the equitable treatment of back pay, but also it is the only rule that "produces a substantive effect that is compatible with the rest of the law." *United Sav.*, 484 U.S. at 371. Under the Government's rule, in a number of circumstances, an employer is rewarded for wrongdoing by relief from FICA and FUTA taxation, or an employee is subject to FICA tax that would never have been imposed but

for his employer's wrongdoing. Such anomalies do not arise in the ordinary course of employment, whether wages are paid in the year of service or as "lag pay" thereafter. Because *Nierotko* alone makes sense of the statute as a whole in the context of back pay, see *United States* v. *Williams*, 514 U.S. 527, 534 (1995) (rejecting Government's interpretation as "inconsistent with other provisions" of the tax statute), Congress presumptively relied upon it in later enacting the statutory provisions detailed above. *Cannon*, 441 U.S. at 696-99.

B. The Government's Rule Is Inconsistent With The Nature of FICA and FUTA As Excise Taxes On The Employment Relation.

The Government's rule is antithetical to the plain language of the statute and this Court's precedent in another respect. By its express terms, Congress imposed the old-age and unemployment taxes on employers as "an excise *upon the employment relation*." *Charles C. Steward Mach. Co.* v. *Davis*, 301 U.S. 548, 578 (1937) (FUTA) (emphasis added); *Helvering* v. *Davis*, 301 U.S. 619, 645 (1937) ("The tax upon employers is a valid excise or duty upon the relation of employment.") (FICA).[20] Those taxes are not imposed on the act of paying wages; rather, as both the statute and the Treasury regulations make clear, "wages paid" during a calendar year is merely the "measure of the tax." 26 C.F.R. §§ 31.3111-1, 31.3301-2; see also 26 U.S.C. § 3111 (imposing excise tax on employment "equal to the following percentages of wages . . . paid by him with respect to employment" for specified years); 26 U.S.C. § 3301 (same).

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[20] 26 U.S.C. § 3111 ("there is hereby imposed on every employer *an excise tax, with respect to having individuals in his employ*") (emphasis added); *id.* §3301 ("[t]here is hereby imposed on every employer (as defined in section 3306(a)) for each calendar year *an excise tax, with respect to having individuals in his employ*") (emphasis added). *Cf. id.* § 3101 (income tax on employees at a rate determined by the wages "received by him with respect to employment").

This Court in *Steward* held that it was constitutional for Congress to tax the employment relation, given that employment was historically subject to excise taxes, and the constitutional authority to impose excise taxes under Article I, Clause 1 was not limited by the nature of the activity. *Charles C. Steward Mach. Co.*, 301 U.S. at 579-82; *Helvering* v. *Davis*, 301 U.S. at 645. Because these are excise taxes on the employment relation, this Court should not interpret the statute to subject identical employment relations to widely varying and inequitable tax burdens based on arbitrary factors.

In the ordinary course of employment, the "wages paid" rule of FICA and FUTA creates no inequity and no penalty to the public fisc. If rates are constant from one year to the next, there is generally no tax effect, because the wages that carry over into the 2000 tax year will generally be offset by those that carry over into the 2001 tax year. Even if the rates increase in the next year, the effect on the ordinary wage earner with carryover wages is minimal.[21] This is in full accord with the legislative history indicating that the "wages paid" rule was adopted as a means of simplifying employer recordkeeping. See *supra* 25-26 n.13. Moreover, there is no structural unfairness in the wages-paid rule; the wage earner would benefit from any tax decrease in a subsequent year (although historically those have not occurred). Circumstances could arise in which the timing of wage payments could have substantial tax effects: for example, where a large bonus is to be paid in 2000 for services performed in 1999 by an employee who is retiring or otherwise terminating his employment with the employer at the end of 1999. But both the employer and the employee have an incentive to

[21] The largest single-year increase in the Social Security (OASDI) tax rate since 1955 was 0.5 percent (in 1960 and 1963). *The 2000 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* 34-35 (Table II.B.1) (2000) ("*2000 OASDI Trustees Report*").

anticipate situations of this kind. Employers and employees thus may structure payment terms (quite legally) to avoid tax anomalies, for example, by accelerating payment to the year of service.

By contrast, the Government's rule results in arbitrary and inequitable taxation of the same employment relation, either to the detriment of the employee and the employer or of the Government. As shown in section II, in many circumstances whether a given employment relation would be taxed at all would depend solely on the timing of the back pay award, contrary to any rational interpretation of the statute. Moreover, the Government's rule may force the injured employee to pay employment taxes twice – often at a higher rate and on a larger part of his wages – simply because of the wrongdoing of his employer.

This case vividly illustrates that inequity. Fifteen former players for the Cleveland Indians who received an award of back pay for 1987 (and eight for 1986) paid the maximum Social Security and Medicare taxes in that year. If they had not been injured by the collective action of the clubs, and had received the additional salary in those years, they would have owed no additional tax. But because of the clubs' wrongdoing that resulted in a back pay award in 1994, all the players who received awards paid federal employment taxes again (and all but one of them paid the maximum in 1994, at higher rates and on a much higher wage base). See *supra* at 4. Cf. *United States* v. *Supplee-Biddle Hardware Co.*, 265 U.S. 189, 195-96 (1924) (constructions of statutes to impose a double tax should be avoided "unless required by express words").

Thus, the Government's rule flatly results in inequitable treatment of identical employment relations where the payment structures were the same. Pitcher A who made $200,000 (or $2 million) in 1987 that is fully paid in that year ends up paying less than half of the tax paid by Pitcher B, who should have been paid $200,000 in 1987, but ends up

receiving $100,000 in 1987 and $100,000 in back pay in 1994 solely because of his employer's wrongful act. This is simply an irrational operation of an employment tax.

Similarly, despite having paid the maximum federal employment taxes on all the players in 1986 and 1987, respondent likewise paid the employer's FICA and FUTA taxes a second time in 1994, at higher rates and on a higher wage base, even though it would have owed no tax had the salaries been properly paid in 1986 or 1987. That double taxation is inequitable and contrary to the statutory scheme, which imposes an excise tax and *not* a penalty.[22] Cf. *Lipke* v. *Lederer*, 259 U.S. 557, 562 (1922) (distinguishing between a tax, which is meant for support of the government, and a penalty, which punishes infractions of the law).

The Government tries to counter the inequity and irrationality of its rule by claiming that "taxing back wages in the year actually paid does not routinely result in additional FICA and FUTA tax liability," and that "less tax would be owed" if the employee had already reached the maximum wage ceiling in the year of the award. U.S. Br. 29 (emphasis omitted). Even if that is true in some cases, the Government's rule harms many classes of vulnerable plaintiffs – namely, retirees, the disabled, or victims of age, race, or sex discrimination – who frequently are not able to secure subsequent employment, or replacement employment at wages anywhere near the annual wage ceiling (which in

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[22] The arbitrariness of the Government's rule is heightened by the fact that federal tax liability will depend on how and when a court or arbitrator makes a back pay decision. If the arbitrator had issued the 1986 salary award in 1994, and the 1987 award in 1995, the employees receiving payments under those awards and respondent would have paid FICA and FUTA taxes again (in most cases, at the maximum amount). Moreover, the arbitrator did make a separate award in 1995 for loss of *nonsalary* benefits in 1986 and 1987. *See supra* at 2 n.2. If the Government succeeds in taxing those awards as wages, respondent and its employees will in effect be triple taxed for the same employment relation.

2001 is $80,400, 65 Fed. Reg. 63,663, 63,663 (2000)). Such an outcome would be particularly inequitable given that back pay awards of this kind "are for the 'protection of the employees and redress of their grievances' to make them 'whole.'" *Nierotko*, 327 U.S. at 365. And the Government's rule will generally be harmful to employer taxpayers in the common case where an individual who wins a back pay award no longer works for the company. As here, the employer will pay the full amount of taxes in the year of the back pay award, no matter what was paid previously. Finally, given the modern trend, all such employees and employers will typically be forced to pay taxes at higher rates and/or on a larger amount of wages.

More importantly, the fact that some taxpayers receive a windfall (by being relieved of tax that would have been paid but for the employer's wrongdoing) is hardly a defense of the Government's rule. There is no reason why this Court should interpret the statute to allow a wrongdoing employer, who should have paid FICA and FUTA taxes in each of the five years covered by a back pay award, to pay only one year's worth of tax in the year of the back pay award. Indeed, that employer may pay no tax at all on the back pay if in the year of the award it has already paid the employee substantial wages for current employment.

A rule that creates potential tax windfalls of this kind will only "invite adroit schemes by some employers and employees to avoid the immediate burdens at the expense of the benefits sought by the legislation." *Silk*, 331 U.S. at 712. For example, an employer who is under the wage ceiling with respect to a certain employee (or class of employees) in a given year may decide to deny overtime pay, knowing that even if it is eventually held liable for back pay, it may have significantly reduced or eliminated tax liabilities for those years (*e.g.*, by deferring multiple years of back pay to a single year with the result that total wages in the calendar year will exceed the wage ceiling). Under *Nierotko*, by contrast, an

employer never has an incentive to create or prolong a wage dispute, regardless of whether wages are below or above the statutory ceiling. Taxation will always relate back to the year in which the taxes should have been paid. 327 U.S. at 370. That is clearly the only viable interpretation of the statute.

Finally, the Government's position is indefensible because it is contrary to the funding scheme of the Act. As discussed above, *supra* at 23-25, by placing taxation and benefits on a common basis in the 1939 Act, Congress created a scheme whereby an individual's benefits would be "reasonably related to contributions and loss of earnings." S. Rep. No. 76-734, at 14. Because the SSA continues to apply *Nierotko* in regard to benefits,[23] where an award covers multiple years of back wages, an individual will receive multiple years of credit towards benefits, but the Government collects only one year of tax (or perhaps none at all).

Although the Government is dismissive of that concern in this litigation, it has previously recognized that such a result is fiscally unsound. In a 1976 General Counsel Memorandum, the IRS decided to treat back pay based on an unlawful failure to hire as "wages" in order to maintain parity

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[23] The Government emphasizes that the SSA has, as a matter of policy, limited *Nierotko* to "'back pay under a statute,'" without explaining the source of the SSA's discretion to constrict this Court's precedent. U.S. Br. 28 n.15 (citing SSA, Dep't of Health & Human Servs., SSR 83-7, 1981-1991 Soc. Sec. Rep. Ser. 18 (1983)). Although the SSA's policy is not directly at issue here, it is flatly inconsistent with *Nierotko*. Nothing in the text of the Social Security Act or *Nierotko* suggests that back pay under a statute is different from other kinds of back pay. *Nierotko* did rely on specific provisions of the National Labor Relations Act in determining whether an NLRB back pay award was "wages" within the meaning of the Act, 327 U.S. at 364-65, but that analysis is not the basis of the distinction drawn by the SSA. The SSA treats all back pay as wages, but arbitrarily denies retroactive benefits credit to employees if the back pay is not awarded under a statute. *Nierotko*'s relation-back holding, which is a construction of the unqualified "wages paid" language of section 209(g) of the 1939 Act, cannot reasonably be limited to back pay under a statute.

with the SSA and thus "protect[] the fisc." Gen. Couns. Mem. 36,732 (May 19, 1976). The IRS reasoned that, unless it followed the same rule as the SSA, "benefits would be paid without proper funding (by corresponding taxes earlier paid)." *Id.* Likewise here, this Court should not adopt an interpretation of the statute that denies the "proper funding" of future benefits by "corresponding taxes earlier paid," *id.*, a particularly grave concern in an era when the Social Security trust funds are not in actuarial balance, *2000 OASDI Trustees Report*, *supra*, at 3.[24] See *United States* v. *W. M. Webb, Inc.*, 397 U.S. 179, 190-91 (1970) (noting importance to Congress of parity in SSA and IRS treatment of maritime employees so as to avoid "an uncompensated drain on the social security fund"); *United States* v. *Lee*, 455 U.S. 252, 258 (1982) (declaring that "mandatory contributions" are "indispensable to the fiscal vitality of the social security system").

C. The Interpretation Of An Employer's Withholding Obligations In *Otte* Is Irrelevant To The Calculation Of The Tax Owed.

Despite the incongruity of its position with the FICA and FUTA statutes as a whole, the Government attempts to rely on *Otte* v. *United States*, 419 U.S. 43 (1974), in which this Court held that a bankruptcy trustee must withhold FICA taxes from delayed wage payments to former employees who worked for the bankrupt company in past years because the employer is obligated to withhold taxes from wages "'*as and when* paid.'" *Id.* at 51 (quoting 26 U.S.C. § 3102(a)) (emphasis added). *Otte* is a red herring because it involves the FICA collection statute, and is irrelevant to the proper calculation of any employment tax that is imposed on back pay. See *Central Ill. Pub. Serv. Co.* v. *United States*, 435 U.S. 21, 29 (1978) (noting, in case involving the income tax,

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[24] This Court may rely upon nonprecedential rulings (like the General Counsel Memorandum) in assessing the validity of the Government's position. *Rowan Cos.* v. *United States*, 452 U.S. 247, 261 n.17 (1981).

that considerations of tax liability "are not necessarily the same as the considerations that support withholding").

The withholding statute, by its terms, places a collection obligation upon the employer only *after* the employee FICA tax is calculated under § 3101; its provisions thus do not speak to the basis or rate of taxation, which is the issue here. See 26 U.S.C. § 3102(a) ("The tax *imposed by section 3101* shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid.") (emphasis added).[25] The employer is liable to the United States as a tax collector for the amount it is required to collect, and indemnified from actions by claims from other persons with regard to the amount withheld. *Id.* § 3102(b).

By prescribing that the employee FICA tax be collected from wages "as and when paid," *id.* § 3102(a), Congress has declared that the collection obligation attaches to each act of payment. Collection (and the employer's liability for the employee's tax) cannot occur until an act of payment, because without payment there would be nothing from which to collect the tax, by withholding or otherwise. This same "as and when" language does *not* appear in the rate-of-tax provisions enacted in the 1939 Act that are at issue here. Moreover, this withholding language was in the original 1935 Act, § 802, 49 Stat. at 636, and has always applied no matter what the measure of the tax. It has no bearing on the calculation of any tax that may be owed or the devising of rules for rational operation of the rate-of-tax provisions of the statute.

The Government claims that *Nierotko* would require employers to withhold taxes for back pay in the year of service (before back pay may even have been sought, much less paid!). U.S. Br. 29-30. Such a requirement, the

[25] The employer is obligated to collect the employee's FICA tax by deduction if the wages are in cash, or by direct collection from the employee if they are not. *See* 26 C.F.R. § 31.3102-1.

Government contends, would conflict with *Otte*, which requires withholding at the time of actual payment. *Id.* at 30. The premise of the Government's argument is false, because *Nierotko* has no implications for withholding. *Nierotko* is a rule for determining the rate of tax that does not affect withholding duties – just like, on the benefits side, *Nierotko* is a rule for determining benefits credit that does not affect reporting obligations. The SSA does not nonsensically require an employer to report "back pay" in the year of service; the report is filed when the money changes hands. Social Sec. Admin., Pub. 957, *Reporting Back Pay and Special Wage Payments to the Social Security Administration* 2 (1997). A similar rule would apply for the taxation of back pay, and would be fully consistent with *Otte*.

As to the Government's general argument that *Nierotko* would create administrative burdens, such arguments are of little force when the rule is required for equitable operation of the Social Security laws. 327 U.S. at 370. Regardless, the Government's argument is vastly overstated. Employers are required by law to retain records of Social Security wages and taxes for each employee. 26 C.F.R. §§ 31.6001-2, 31.6001-4. Most importantly, employers *already* allocate back pay to prior years of service in their reports to the SSA for application of *Nierotko*, and having a unified *Nierotko* rule would create no added burden because the same apportionment would be used for tax purposes. Once back pay is apportioned, the calculation of taxes owed is simple. The back pay is added to prior wages for the year in question, the tax is recalculated upon the new wage total (to the extent it is below the wage ceiling for that year) based on the rates in effect in the prior year, and any balance above what had been previously paid would be paid to the IRS. Thus, compared to other tax reporting and accounting requirements imposed on

employers, any additional administrative burden from applying the proper statutory rule is *de minimis*.[26]

III. THE GOVERNMENT'S INTERPRETATION IS NOT ENTITLED TO DEFERENCE.

The Government's claim that the IRS's interpretation of the FICA and FUTA statutes is entitled to deference should also be rejected.

First, the Government's argument that the Treasury regulations reject the *Nierotko* rule for back pay is badly misplaced and founded on the Government's misunderstanding of *Nierotko*. The Treasury regulations do not even address back pay, and (as the Government acknowledges, U.S. Br. at 19 n.10) are substantively unchanged from a period prior to *Nierotko* in which the IRS held a position on back pay that was rejected as "unsound" by this Court. 327 U.S. at 367. Moreover, far from addressing back pay, those regulations stood (and stand now) for the general proposition that the rate of FICA excise tax is measured by "wages paid" in a calendar year, rather than "wages payable." Cf. U.S. Br. 19-20, 24-25 and regulations cited therein. The Government's erroneous claim that *Nierotko* requires taxation on a "wages payable" basis, and thus conflicts with these regulations, see *id.*, again stems from its fundamental failure to recognize that *Nierotko* is a construction of a "wages paid" statute as applied to back pay, not a revival of the "wages payable" rule. Because the regulations are silent as to when remuneration in the form of back pay is considered "paid" for

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[26] The administrative burdens of applying *Nierotko* are far less than the burdens of administering the elaborate rules for FICA and FUTA taxation of nonqualified deferred compensation plans, which require deferred amounts to be taxed in the later of the year when services are performed or when there is no substantial risk of forfeiture, 26 U.S.C. § 3121(v)(2)(A). *See* 26 C.F.R. § 31.3121(v)(2)-1. Congress has required these burdens to avoid tax inequity and gamesmanship that would result from the deferral of taxation to the year when such compensation would actually be paid.

tax purposes, that leaves this Court's opinion in *Nierotko* as the long-standing, unchanged authority on this issue. If Congress is to be deemed to have approved of an interpretation of the FICA and FUTA rules concerning back wages, it should be this Court's interpretation, not that put forth by the IRS. *Cottage Sav. Ass'n* v. *Commissioner*, 499 U.S. 554, 562 (1991) ("[B]ecause Congress has left undisturbed through subsequent reenactments of the Code the principles of realization established in these cases, we may presume that Congress intended to codify these principles."). *Nierotko* is a "wages paid" rule for the exceptional circumstance of back pay that is not addressed in the regulation, and is fully consistent with the regulation.

The IRS has issued more specific guidance addressing the taxation of back pay, but it has taken the form of revenue rulings, not regulations. See U.S. Br. 20 (citing, *e.g.*, Rev. Rul. 89-35, 1989-1 C.B. 280). Agency interpretations of this nature, which do not benefit from the reflection and discourse provided by notice-and-comment procedures or adjudications, are not entitled to deference under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984), because they do not have the force and effect of law. *Christensen* v. *Harris County*, 120 S. Ct. 1655, 1662 (2000); *Bartels* v. *Birmingham*, 332 U.S. 126, 132 (1947) (revenue rulings "do not have the force and effect of Treasury Decisions"); *United States* v. *Swank*, 451 U.S. 571, 579 & n.13 (1981) (rejecting IRS interpretation of statute and regulation that was embodied in a revenue ruling).

In any event, whether it is acting through a regulation or ruling, the IRS lacks the authority to interpret a statute in a manner that conflicts with a prior interpretation by this Court. *Maislin Indus.* v. *Primary Steel, Inc.*, 497 U.S. 116, 130-31 (1990); *Neal* v. *United States*, 516 U.S. 284, 295 (1996). In such circumstances, the prior ruling by the Court is controlling under the doctrine of stare decisis and any agency interpretation to the contrary should be disregarded. *Id.* Even

if *Nierotko* were not controlling, it would at least be incumbent upon the IRS to distinguish it based on a proper conception of the statutory basis for the decision. Instead, Revenue Ruling 89-35 fails to address *Nierotko* as an interpretation of a "wages paid" statutory rule from the same 1939 Act that enacted the tax provisions at issue here. This ruling is little more than a cursory recitation of the statutory language and a reiteration of the Government's unsuccessful arguments before the Sixth Circuit in *Bowman*. See Rev. Rul 89-35, 1989-1 C.B. 280.

Finally, an IRS interpretation of a statute is never afforded deference if it does not harmonize with the statutory, language, origin, structure and purpose. *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979); *Rowan Cos.* v. *United States*, 452 U.S. 247, 252-53 (1981). As noted above, the IRS interpretation fails to distinguish *Nierotko* or address the legislative history and structure of the Social Security Act; results in arbitrary and inconsistent taxation of employees and employers; and creates conflicting rules for purposes of determining benefits and computing taxes, all of which do violence to the basic funding and fairness principles of the Act. *See supra* at 41-45. The IRS's exclusive focus on the words "wages paid" in the FICA tax statute has caused it to disregard the broader structure and purpose of the FICA statute in adopting its interpretation. Such myopia does not illuminate a statute's plain meaning and is not worthy of deference. *National R.R. Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407, 417 (1992) ("In ascertaining whether the agency's interpretation is a permissible construction of the language, a court must look to the structure and language of the statute as a whole.").

CONCLUSION

This Court should affirm the judgment below.

Respectfully submitted,

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